

Can a Condominium Association File a Chapter 7 Bankruptcy Petition?

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Over the years that I have been practicing in the U.S. Bankruptcy Courts as well as representing Condominium Associations, the question has periodically come up of whether a Condominium Association could file for bankruptcy protection. This question, at least in part, was recently answered by the United States Bankruptcy Appellate Panel for the First Circuit.



The subject case arose in the Bankruptcy Court of Puerto Rico involving the “Asociacion De Titulares De Condominio Castillo”, (hereinafter “Castillo”). Castillo is a 22 unit association located in San Juan, Puerto Rico which had a recent involvement and challenge from the U.S. Department of Housing and Urban Development (“HUD”). It was alleged that Castillo had forced a unit owner (“DiMarcos”) to sell his unit because he was keeping a dog in violation of the “no pets” provisions of the bylaws. Thereafter HUD filed an action of discrimination against Castillo under the Fair Housing Act claiming that its refusal to allow a unit owner to keep an emotional support dog in his unit was a violation of the Act. Following a 4 day evidentiary hearing the administrative law judge (“ALJ”) found in favor of Castillo!

But unfortunately for the association it didn’t stop there. HUD appealed the ALJ’s decision to the Secretary of HUD who heard the case on an administrative appeal and thereafter overturned the decision of the ALJ, finding instead for the unit owner. The case was remanded back the ALJ for determination of damages. The ALJ issued her decision for damages which HUD appealed once again to the Secretary. Through the several back and forth levels, Castillo was eventually found liable for violating the Fair Housing Act, and ordered to pay \$20,000.00 in damages to DiMarcos and \$16,000.00 in civil Penalties. See Castillo Condo. Ass’n v. United States HUD, 821 F.3d 92, 2016 U.S. App. LEXIS 7951. It is because of this decision that Castillo attempted to file for bankruptcy protection.

Castillo thereafter filed a voluntary Chapter 7 bankruptcy petition in June of 2016. In its original bankruptcy schedules, Castillo listed a minimal amount of assets of \$14,048.12 and liabilities of \$104,515.00 with the majority of the debt being owed to 3 creditors, including DiMarcos. At the §341 Meeting of Creditors the president of the Board indicated that the association had ceased doing business with the filing of the bankruptcy case, and that the homeowners created a new association moving forward. She further stated that the purpose of the bankruptcy filing was to avoid collection of the judgement debts.

DiMarcos thereafter filed a motion to dismiss Castillo’s bankruptcy petition under Title 11 U.S.C. §707(a) claiming, among other assertions, that Castillo was not a person as defined by §109(41) and could not sustain a bankruptcy case. Under §109(41) of the Code, it provides that “the term ‘person’ includes individual, partnership, and corporation, but does not include governmental unit...” for purposes of filing a bankruptcy petition under Chapter 7 of the

bankruptcy code. Following several non-evidentiary hearings the court concluded that Castillo did not fall under the definition of a person, and therefore was not eligible for bankruptcy relief. Several weeks later the court further found that the bankruptcy filing demonstrated a “lack of a legitimate bankruptcy purpose”. It was these determinations which generated Castillo’s appeal to the Bankruptcy Appellate Panel of the First Circuit. (“BAP”)

In its review of the case the BAP first concluded that the First Circuit “has not expressly address(ed) (sic) whether a condominium association constitutes a ‘person’ under §101(41) or whether it may be a debtor under §109(a)”. Either way, the issue was a case of first impression for the BAP. It then settled down to analyze the rulings of the bankruptcy court and its holdings that Castillo was not eligible to qualify as a debtor, and that the case was filed, in essence, in bad faith.

First tackling the definition of ‘person’ the BAP confirmed and summarized that:

“§101(41) provides that '[t]he term 'person' *includes* individual, partnership, and corporation[.]' 11 U.S.C. §101(41) (emphasis added). The bankruptcy court interpreted §101(41) to mean that *only* those entities specifically identified in §101(41)- individuals, partnerships, and corporations- are 'persons' under the Bankruptcy Code that are eligible for bankruptcy relief. And, the court concluded, because the Asociacion was not an individual, partnership, or corporation, it was ineligible to be a debtor.”

The BAP went further in stating that although Castillo did not fall into any of the delineated definitions of a ‘person’ under §101(41) the court should have considered whether the legal characteristics of Castillo were sufficiently analogous to other entities such as a partnership or corporation. Having determined that the bankruptcy court’s review and application of the definition of a ‘person’ to be a narrow and exclusive reading of §101(41), “without any supporting legal authority”, the BAP thereafter opined that: “we conclude the bankruptcy court committed legal error when it applied a narrow, exclusive interpretation of the term ‘person’ set forth in §101(41) in determining that the Asociacion [de Titulares de Condominio Castillo] was not eligible to be a debtor under §109.”

However, the BAP did sustain the bankruptcy court’s dismissal of Castillo’s bankruptcy case concluding “that there was no legitimate bankruptcy purpose to be served” and that the dismissal of the bankruptcy case was supported by the facts.

Going forward, at least through the BAP level of the First Circuit, a condominium association could file for bankruptcy protection under Chapter 7 and get by the first of many hurdles bankruptcy debtors face throughout their case. Whether a bankruptcy case could be sustained through a successful conclusion, well, that is still to be determined.